Exhibit WM-4

THE COMMONWEALTH OF MASSACHUSETTS
before the
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

WESTERN MASSACHUSETTS ELECTRIC COMPANY

D.T.E. 00-40

PETITION FOR THE ISSUANCE OF ELECTRIC RATE REDUCTION BONDS

direct TESTIMONY OF

mark a. englander

ON BEHALF OF
WESTERN MASSACHUSETTS ELECTRIC COMPANY

April 18, 2000

I. INTRODUCTION *

II. WMECO’S PROPOSED RRB TRANSACTION *

A. OVERVIEW *

B. THE SPE AND THE TERMS AND ISSUANCE OF SPE DEBT SECURITIES *

C. THE TERMS AND ISSUANCE OF RRBs *

D. CREDIT ENHANCEMENT *

E. SERVICING THE TRANSITION PROPERTY *

F. ACCOUNTING AND TAX CONSEQUENCES *

G. ESTIMATE OF TRANSACTION COSTS *

H. PARTICIPATION OF THE STATE AGENCIES *

III. CONCLUSION *

ATTACHMENT A *

THE COMMONWEALTH OF MASSACHUSETTS

before the
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

WESTERN MASSACHUSETTS ELECTRIC COMPANY

D.T.E. 00-40

PETITION FOR THE ISSUANCE OF ELECTRIC RATE REDUCTION BONDS

direct TESTIMONY OF

mark a. englander

ON BEHALF OF
WESTERN MASSACHUSETTS ELECTRIC COMPANY

INTRODUCTION

Will you please state your name, present position, and business address.

My name is Mark A. Englander. I am a Senior Financial Analyst in the Finance Group of Northeast Utilities ("NU") System's Treasury Department. My business address is 107 Selden Street, Berlin, Connecticut.

What are your responsibilities in your current position?

I act as Team Leader on various securitizations being pursued by NU's operating companies and affiliates, specifically Western Massachusetts Electric Company ("WMECO"), The Connecticut Light and Power Company and the Public Service Company of New Hampshire. In such capacity, I am responsible for ensuring that the contemplated securitization transactions are successfully carried out.

What is your educational background?

In February 1991, I received a Masters Degree in Business Administration with Distinction from Western New England College in Massachusetts. In May 1987, I received a Bachelors of Business Administration Summa Cum Laude from American International College in Massachusetts. I have successfully completed the Fleet Bank Corporate Credit Training Program, a six-month full-time intensive program devoted solely to credit and lending issues.

What professional designations or affiliations do you have or did you attain?

I am a Certified Public Accountant. I do not currently practice, but have been affiliated with the American Institute of Certified Public Accountants and the Connecticut Society of Certified Public Accountants.

Please summarize your professional experience.

I joined the Treasury Department of NU in February 1996 as a Financial Analyst in the Finance Group. This Group is responsible for raising the capital necessary to meet NU's long-term and short-term financial requirements, primarily through asset-backed securitizations and the issuances of first mortgage bonds, pollution control revenue bonds, notes, lease obligations, preferred stock, common stock and short-term bank notes. I was promoted to Senior Analyst in May 1998.

Prior to my tenure at NU, I spent approximately five years of increasing responsibility in the Asset Backed Lending division of Fleet Financial Group, in Boston and Hartford. I held the positions of Credit Analyst, Portfolio Manager and Associate Relationship Manager. I was responsible for managing the underwriting process, deal structure, financial analysis, profitability and ultimately, the credit quality of a nine figure portfolio of loans. Prior to that, I spent approximately two years as a Certified Public Accountant for PricewaterhouseCoopers, LLC, primarily auditing public and private corporations.

Please describe your experience related to the subject of securitization.

I have been analyzing securitization and following its wide-spread implementation since 1995. I have testified before the New Hampshire Public Utilities Commission with respect to the contemplated Public Service Company of New Hampshire securitization transaction. In addition, my staff and I have significant exposure to Wall Street firms specializing in these transactions, as well as other companies and their counsels who have executed stranded cost securitizations. I have assisted in several presentations made by our Treasurer as a panelist on this topic at various

conferences across the country and have attended many professional seminars on the subject.
What is the purpose of your testimony?
The purpose of my testimony is to support WMECO’s application seeking approval of the proposed transaction. I provide an overview of WMECO’s proposed electric rate reduction bonds transaction ("RRB Transaction"), and then proceed to describe the:
Special purpose entity to be created and the terms and issuance of the notes to be issued by such special purpose entity;
Issuance of the RRBs (as defined below);
Role of credit enhancement;
Servicing the transition property;
Timing of the RRB issuance and tax consequences;
Estimate of transaction costs; and
Role of the Massachusetts Development Finance Agency and the Massachusetts Health and Educational Facilities Authority (collectively, "Agencies") in the proposed transaction.
In addition, in Attachment A to this testimony ("Attachment A"), I provide an overview of securitization and the basic structure of a typical asset-backed securities transaction, as well as other relevant background information.

What approvals is WMECO seeking from the Department of Telecommunications and Energy ("Department") in this proceeding?
WMECO is petitioning the Department for a financing order ("Financing Order") approving the issuance of electric rate reduction bonds ("RRBs") in the aggregate principal amount of approximately $261 million and related transactions, pursuant to the terms of General Laws c. 164, §§ 1G and 1H ("§ 1G" and "§ 1H," respectively). WMECO proposes that the Financing Order contain those approvals necessary to authorize the issuance of the RRBs, including those set forth in its petition ("Petition").
The language in the Financing Order must be drafted in a way that maximizes the likelihood of achieving triple-A ratings on the RRBs and enhances the marketability of the RRB issuance. Accordingly, WMECO is filing with the Petition a proposed Appendix 1 to the Financing Order ("Proposed Financing Order Appendix") containing a detailed description of the RRB Transaction, together with requested findings and orders, which is attached as Exhibit WM-1 to the Petition. WMECO respectfully requests that the Department incorporate into the Financing Order the Proposed Financing Order Appendix.

WMECO’S PROPOSED RRB TRANSACTION
OVERVIEW
Please summarize the proposed WMECO RRB Transaction.
The following steps illustrate the proposed RRB Transaction and the cash flows involved:
As discussed in more detail in the testimony of Mr. Soderman, the Department has determined that certain of WMECO’s costs are transition costs ("Transition Costs") eligible for recovery through collection of a transition charge ("Transition Charge") under § 1G. Under § 1H, a portion of such Transition Charge may be securitized (such portion, once securitized, "RTC Charge") through the issuance of RRBs.
WMECO’s right to collect the RTC Charge is irrevocable, pursuant to a pledge by the Commonwealth of Massachusetts in § 1H(b)(3), and the charge itself is nonbypassable to each WMECO customer or ratepayer taking delivery, transmission, distribution, back-up, maintenance, emergency or any other delivery or energy service provided by WMECO to such customer, regardless of that customer’s source of electric power (referred to herein, "Retail Customer").
WMECO will create one or more bankruptcy-remote special purpose entities (each, an "SPE"), wholly-owned by WMECO. Each such SPE will constitute a "financing entity" for purposes of § 1G and § 1H. WMECO will capitalize each SPE in an amount anticipated to be at least 0.50% of the initial principal balance of RRBs issued with respect to that SPE. It is anticipated that each SPE will need to enter into an administration agreement ("Administration Agreement") with WMECO pursuant to which WMECO shall perform administrative services and provide facilities for each SPE to ensure that it is able to perform such day-to-day operations as are necessary to

maintain its existence and perform its obligations under the RRB Transaction documents. The Administration Agreement incorporates provisions to ensure that WMECO will be paid a fee ("Administration Fee") in an amount commensurate with its costs of performing such services and providing such facilities.
WMECO will sell its right to collect the total amount of RTC Charges calculated over the life of the RRBs ("Transition Property") to an SPE in a transaction that will be intended to be and will be treated as a legal true sale and absolute transfer to such SPE.
WMECO, or any successor servicer ("Servicer"), will act as servicer for the Transition Property under a servicing agreement ("Servicing Agreement").
The SPE will issue and sell notes ("SPE Debt Securities") to a special purpose trust established by the Agencies.
All of the assets of such SPE, specifically the Transition Property and the other collateral of the SPE ("Other SPE Collateral"), will be pledged as collateral to secure the SPE Debt Securities. The Other SPE Collateral will include without limitation, (a) the rights of each SPE under all RRB Transaction documents including (i) the sale agreement ("Sale Agreement") by which each SPE acquires all rights in the Transition Property (and including any hedging agreement in place with respect to variable rate RRBs), (ii) the Servicing Agreement, and (iii) the Administration Agreement, and (b) the rights of each SPE in and to the collection account ("Collection Account") and any subaccounts established therein including the general subaccount ("General Subaccount"), the overcollateralization subaccount (the "Overcollateralization Subaccount"), the capital subaccount ("Capital Subaccount"), and the reserve subaccount ("Reserve Subaccount"), and any investment earnings on amounts held by such SPE (but excluding an amount equal to investment earnings on the initial capital contributed by WMECO, which will be returned to WMECO semiannually or more frequently as a distribution of capital by the SPE so long as there are sufficient moneys to make scheduled distributions of interest and principal on the RRBs and pay required financing expenses).
The special purpose trust, constituting a "financing entity" under § 1G and § 1H, will issue and sell the RRBs, which will represent undivided beneficial interests in the SPE Debt Securities and any interest rate exchange agreement or other hedge arrangement (collectively, a "hedging agreement") entered into in connection with the transaction. The RRBs will be payable solely from cashflows associated with Transition Property, primarily the RTC Charge. The net proceeds from the sale of the RRBs will be remitted to the SPE as consideration for the SPE Debt Securities and, ultimately, remitted to WMECO as consideration for the Transition Property.
If variable rate RRBs are issued (as described below), the trustee of the special purpose trust will enter into a hedging agreement whereby the special purpose trust would make fixed payments to a counterparty, and the counterparty would make variable rate payments to the special purpose trust for the benefit of RRB holders. These fixed rate payments would be used to calculate the RTC Charge. This protects the special purpose trust and WMECO’s customers against the risk that interest rate fluctuations would cause variable rates to exceed the fixed rates on the SPE Debt Securities that were used to calculate the RTC Charge.
After the RRB issuances, the ongoing cash flows of the proposed transaction include: (i) the billing and collection of the RTC Charge from Retail Customers by WMECO, acting as Servicer on behalf of the SPE, (ii) the transfer of the RTC Charge collections to the SPE (although limited commingling may be permitted under certain circumstances subject to rating agency conditions); (iii) the payment of principal and interest on SPE Debt Securities to the trustee for the RRBs ("RRB Trustee") by the trustee for the SPE Debt Securities; and (iv) the payment of principal and interest to holders of the RRBs, by the RRB Trustee. The Servicer or any successor Servicer will be paid a Servicing Fee by the SPE as consideration for the performance of servicing duties.
Given WMECO’s lower credit rating compared to other issuers, WMECO may be required to obtain a letter of credit or other credit enhancement to protect against any cash collection losses resulting from the temporary commingling of funds.
The following diagram summarizes the overall transaction structure, the parties to the transaction, and their roles and relationships to each other:

PARTIES TO TRANSACTION

Are the terms of the RRB Transaction, as described in the Petition and this testimony, the final terms of the proposed transaction?
No. Certain details regarding the issuance of the RRBs, including without limitation, interest rates and the expected and legal maturity dates, are entirely dependent upon market conditions at the time the bonds are issued, and until that time such terms cannot be finalized. Additionally, once the rating agencies have performed their due diligence and the required Overcollateralization Amount (described below) and the initial equity capital has been established, changes to the terms of the transaction may be required.
When will WMECO provide the Department with the final terms of the RRBs?
Prior to the issuance of RRBs, WMECO will file with the Department an issuance advice letter substantially in the form of Appendix A to the Proposed Financing Order Appendix ("Issuance Advice Letter"), subject to the approval of the Agencies, which will state the final terms of any series of RRBs.
Is WMECO’s proposed RRB Transaction similar to other RRB transactions that have closed to date?
Yes. WMECO’s proposed RRB Transaction is very similar to prior RRB transactions, including the Boston Edison Company RRB transaction approved by the Department. For example, the RRB transactions set forth in Attachment A are all similar to WMECO’s proposed RRB Transaction in that they are (i) securitizations of an irrevocable right (created by statute and regulatory order) to collect nonbypassable charges from customers; (ii) rated triple-A by at least Moody’s Investors Service, Standard & Poor’s, and Fitch IBCA, Inc.; (iii) issued in multiple tranches (classes) with varying maturities and average lives; (iv) well-received by investors; and (v) trading with similar spreads to benchmark securities. Further, the types of credit enhancement utilized in these transactions are substantially similar to those proposed by WMECO herein, including both true-ups and overcollateralization. WMECO may be required to obtain a letter of credit or other credit enhancement to protect against any cash collection losses resulting from the temporary commingling of funds.
THE SPE AND THE TERMS AND ISSUANCE OF SPE DEBT SECURITIES
Please describe the formation and capitalization of the SPE.
WMECO will form an SPE, which will be a bankruptcy-remote limited liability company organized under the laws of Delaware and wholly-owned by WMECO. The SPE will qualify as a "financing entity" under § 1H(a), to which Transition Property may be sold or

assigned.
WMECO anticipates that each SPE will be required to be capitalized in an amount equal to at least 0.50% of the initial principal balance of RRBs issued with respect to such SPE, although the actual amount will be subject to prevailing market conditions at the time of RRB pricing and input from the rating agencies and tax authorities. The funds for such capitalization will be contributed by WMECO and placed in the Capital Subaccount, and will be available to make payments on RRBs if necessary and such funds will be replenished through the True-Up Mechanism (all as described below). An amount equal to investment earnings earned on the initial capital contributed by WMECO will be returned to WMECO semiannually or more frequently as a distribution of capital by the SPE so long as there are sufficient moneys to make scheduled distributions of interest and principal on the RRBs and pay required financing expenses.

Each SPE will be managed by a management committee, which will have all the rights and authority similar to that of a board of directors for a corporation. As long as the SPE Debt Securities and the RRBs remain outstanding, WMECO shall be required to cause each SPE to have at least two independent directors or managers (i.e., directors or managers that are not affiliated in any way with WMECO). Without the consent of these independent directors or managers, each SPE will be unable (a) to amend provisions of fundamental organizational documents which ensure the bankruptcy-remoteness of such SPE, (b) to institute bankruptcy or insolvency proceedings or to consent to the institution of bankruptcy or insolvency proceedings against it, or (c) to dissolve, liquidate or wind up the SPE. Other provisions may also be included to support the bankruptcy-remote character of each SPE as required by the rating agencies.

Explain what it means for the SPE to be "bankruptcy-remote" from WMECO.
An important component of the proposed transaction is that the SPE must be "bankruptcy-remote" from WMECO – i.e., legally insulated from WMECO credit risk, including a potential WMECO bankruptcy. In other words, the SPE and its assets would not be consolidated into a WMECO bankruptcy estate. This bankruptcy-remoteness is supported by the form of the SPE and its organizational documents. The SPE will have a legal identity separate from that of WMECO and it will be apparent to readers of WMECO’s financial statements that the assets of the SPE are distinct from those of WMECO. The SPE will have no assets other than the Transition Property and Other SPE Collateral. Other provisions may also be included to support the bankruptcy-remote character of each SPE as required by the rating agencies.
Describe the legal true sale of the Transition Property to the SPE.
WMECO will sell all of its rights in the Transition Property to one or more SPEs in transactions that will be intended to be and will be treated as a legal true sale and absolute transfer to such SPE, notwithstanding contrary treatment of such transfer for accounting, tax, or other purposes. As such, if WMECO were to become the subject of a bankruptcy proceeding, the Transition Property would not be considered part of WMECO’s bankruptcy estate, and therefore would not be subject to the claims of WMECO’s creditors. Although WMECO will collect the billed RTC Charges as Servicer for the RRBs (discussed below), for legal purposes the Transition Property will remain isolated to the extent possible from WMECO’s revenues and assets. WMECO will sell the Transition Property to the SPE for an amount equal to the issue price of the RRBs less any transaction costs paid directly by the SPE and the special purpose trust from the proceeds of the RRBs. The treatment of the transfer of the Transition Property as a legal true sale is consistent with the treatment contemplated by § 1H(f)(1). The combination of the bankruptcy-remote character of the SPE and the legal true sale of the Transition Property allows for the highest possible credit rating for the RRBs and the greatest possible savings to WMECO’s Retail Customers. Notwithstanding these structural protections, WMECO may be required to obtain a letter of credit or other credit enhancement to protect against any cash collection losses resulting from the temporary commingling of funds.
The rating agencies will require acceptable opinions of bankruptcy counsel at the time the SPE Debt Securities and the RRBs are issued as to the bankruptcy-remote character of the SPE and the legal true sale of the Transition Property.

What rights does each SPE obtain through the purchase of the Transition Property?

Upon the sale of the Transition Property to the SPE, such SPE will have all of the rights originally held by WMECO with respect to the Transition Property, including without limitation, the right to exercise any and all rights and remedies to collect any amounts payable by any Retail Customer with respect to the Transition Property and Other SPE Collateral, all rights to obtain periodic adjustments and non-routine adjustments to the RTC Charge and the right to authorize the disconnection of electric power in accordance with and to the extent permitted by G.L. c. 164, §§ 124, 124A- I, and any applicable regulations, notwithstanding any objection or direction to the contrary by WMECO.
Please describe the terms and issuance of the SPE Debt Securities.
The SPE will issue promissory notes, the SPE Debt Securities, to the special purpose trust in one or more series. Each series of SPE Debt Securities may be offered in one or more classes, each having a different principal amount, term, interest rate, and amortization schedule. The SPE Debt Securities are expected to be sold at or near par value and will not in any event be sold for more than par value. All accrued interest on the SPE Debt Securities will be paid not less frequently than semiannually. Principal payments are expected to be applied in sequential class order within each series until the outstanding balance of such class or series is reduced to zero. Under certain circumstances determined by the Agencies, WMECO and its underwriters, the SPE Debt Securities will also be subject to call provisions. The SPE will initially issue at least one series of SPE Debt Securities. Each series will be divided into one or more classes, each of which will likely receive principal payments at different times, resulting in different expected and legal final maturity dates. WMECO expects that the SPE Debt Securities will have scheduled (expected) maturities of 12 years and have legal maturities not longer than 15 years.

The interest rate, term, classes, and other characteristics of the SPE Debt Securities will be determined at the time of issuance based on then-current market conditions.

The SPE, the special purpose trust, and the holders of the RRBs will expressly agree under the terms of the applicable documents to treat the SPE Debt Securities as debt of the SPE for all purposes. For financial reporting purposes, the SPE Debt Securities will be treated as debt of WMECO.

The SPE Debt Securities will be nonrecourse to WMECO but will be secured by a first priority statutory lien on all Transition Property as provided in § 1H(e), together with a pledge of the Other SPE Collateral. This includes (i) the Transition Property, (ii) the Collection Account, (iii) all amounts or investment property on deposit in or credited to the Collection Account from time to time, (iv) all other property of whatever kind (other than certain amounts owing to certain service providers or trustees) owned from time to time by the SPE, and (v) all rights of the SPE in and to the transaction documents such as (a) the purchase agreement by which the SPE acquires the Transition Property and (b) the Servicing Agreement by which WMECO or any successor thereto acts as Servicer for the Transition Property. The SPE Debt Securities will not be subordinated to the claims of any creditors or the equity owner of the SPE, other than for payments of trustee and servicing fees.

Please describe the formation of the Agencies-sponsored special purpose trust.
The Agencies, acting jointly, will establish a trust under the business trust law of Delaware. A Delaware business trust will be used because of its familiarity to the asset-backed market. The trust will qualify as a "financing entity" and as a "special purpose trust" pursuant to § 1H(a). A nationally recognized bank or trust company will serve as trustee of the special purpose trust. The assets of the special purpose trust will include the SPE Debt Securities, any letters of credit or other credit enhancement, and any hedging agreement entered into by the special purpose trust if a series or class of RRBs is issued with a variable interest rate.
THE TERMS AND ISSUANCE OF RRBs
Please describe the terms and issuance of the RRBs.
The special purpose trust will issue the RRBs to underwriters, who in turn will sell the RRBs to capital market investors. The RRBs will be in the form of pass-through certificates representing beneficial ownership interests in the SPE Debt Securities

and any hedging agreement entered into in connection with the transaction. Each class of each series of RRBs will represent fractional undivided interests in a corresponding class of a series of SPE Debt Securities held by the special purpose trust and the proceeds thereof. Therefore, each class of RRBs will have a principal amount, term, interest rate, amortization, and call provisions that are identical to the corresponding class of SPE Debt Securities and any hedging agreement. The RRBs also will be secured by a statutory lien on the Transition Property to the extent provided by § 1H(e). WMECO also expects to file a financing statement with respect to the Transition Property which will constitute a protective filing pursuant to § 1H(e).
The special purpose trust will transfer the proceeds from the issuance of the RRBs, net of its transaction expenses, if any, to the SPE, as consideration for the SPE Debt Securities. The SPE will then transfer to WMECO, as consideration for the transfer of the Transition Property to the SPE, the balance of such RRB proceeds, net of any remaining transaction expenses.

The targeted ratings on the RRBs will be triple-A. Because each class of RRBs will likely receive principal payments at different times, each will have different expected and legal final maturity dates. WMECO expects that the RRBs will have scheduled (expected) maturities of 12 years and have legal maturities not longer than 15 years.

The RRBs are expected to be sold at or near par value and will not in any event be sold for more than par value. All accrued interest on the RRBs will be paid not less frequently than semiannually. Principal payments are expected to be applied in sequential class order within each series until the outstanding balance of such class or series is reduced to zero. Under certain circumstances determined by the Agencies, WMECO and its underwriters, the RRBs will also be subject to call provisions.

Neither the RRBs, the SPE Debt Securities, or the Transition Property, which secures the SPE Debt Securities, is an obligation of the Commonwealth or any of its political subdivisions (other than the special purpose trust) or of WMECO or any of its affiliates, except for the SPE, which is an affiliate of WMECO. The RRBs will be nonrecourse to WMECO and its assets, and, in accordance with § 1H(b)(4)(i), will not be secured by a pledge of the general credit, full faith or taxing power of the Commonwealth or any agency or subdivision of the Commonwealth (other than the special purpose trust).

Will the RRBs be sold in multiple classes or tranches?
The RRBs will likely be sold in multiple classes with different maturities and paying principal at different times, such that investors will have a wider range of maturities to choose from and resulting in the ability for WMECO to target a broader investor group and optimizing pricing. Dividing the RRBs into classes also minimizes the principal payment window, the time over which the holders of a class are expected to receive principal. As investors charge a "premium" for receiving principal over time, minimizing the principal payment window will result in a lower borrowing cost. To the extent that principal payment windows are smaller, other things being equal, spreads will also be lower. The number of classes will not only depend on maturity target and principal payment window considerations, but each class will have to be large enough to maintain liquidity. Thus, a smaller transaction would generally have fewer classes and larger payment windows than a larger transaction in order to maintain liquidity within each class.
Have precedent transactions been marketed in a similar fashion?
Yes, every precedent public transaction has been marketed this way. A table in Attachment A illustrates the principal payment windows and the corresponding class sizes for the four precedent transactions issued in 1999.
At what rates have precedent transactions been priced and how is this determined?
The tables set forth in Attachment A show the rates at which the PECO Energy, Boston Edison and West Penn Power rate reduction bonds priced. For each fixed-rate class, the risk-free security, usually a US Treasury bond, that most closely matches the weighted average life of the class is chosen as the benchmark. The spread is the premium which investors deem appropriate compensation for the additional risk beyond

U.S. Treasury they take on when buying the rate reduction bonds. This spread is determined as investors compare the terms of the transaction with actively traded comparable securities, including outstanding rate reduction bonds and other "asset-backed securities" (primarily credit cards).
As has been the case in prior transactions, the RRBs may be priced at a minimal discount, resulting in a yield slightly exceeding the coupon.

It is important to note that while the coupon for each class of RRBs will be set at pricing, as the RRBs amortize and shorter-term classes are repaid, the weighted average coupon on the aggregate RRB issuance will change.

Will the RRBs pay fixed-rate or variable-rate interest, and if variable, how will you ensure that customers do not bear the risk of an increase in short term interest rates?
WMECO currently anticipates that the RRBs will be fixed-rate instruments, and will only issue variable rate RRBs if such issuance, as determined by WMECO, subject to the approval of the Agencies on behalf of the special purpose trust, will result in a lower net interest cost on the RRBs. If variable rate RRBs are issued, the RRB Trustee and the SPE will enter into a hedging agreement to protect the SPE and the ratepayers against the risk that interest rate fluctuations would cause variable rates to exceed the fixed rates that were used to calculate the RTC Charge. These instruments will ensure that the level of the RTC Charges will not be subject to volatility as a result of changes in future market rates of interest. In other words, to the extent that the variable rate of the RRBs ever exceeds the fixed rate that was used to calculate the RTC Charge, a mechanism would be in place to absorb the rate increase that would otherwise be required to fully pay the interest on the bonds.
What will the rating agencies consider when establishing the credit rating for the RRBs?
The rating agencies will focus their analyses on the bankruptcy-remoteness of the SPE, the legal true sale of the transition property, the nonbypassability of the RTC Charge, the Commonwealth’s pledge not to alter or impair the Transition Property, the standards governing so-called "third party suppliers" (described below), the ability to pay timely interest (and ultimate principal) under a wide range of scenarios where cash flow is assumed to be significantly reduced ("cash flow stress tests"), credit enhancements (described below), and any factor that has the potential to interfere with RTC Charge collections. As a result, some of the key items the rating agencies will study are the overall structure of the proposed RRB Transaction, the RTC Charge True-Up Mechanism, the historical number, usage patterns, and payment patterns of WMECO’s customers, the volatility of these factors and trends over time, the sensitivity that a change in the factors could have relative to a reduction in RTC Charge collections, and WMECO’s ability to forecast these factors and trends.
Why is the Commonwealth’s pledge so important?
The Commonwealth’s pledge eliminates the risk that § 1G or § 1H will be rescinded or altered in a manner adverse to the RRB holders. The Commonwealth’s explicit pledge will provide the rating agencies and investors with assurance that neither the Commonwealth nor the Department will limit, alter, impair, or reduce the value of Transition Property until the RRBs are fully discharged, resulting in a higher credit rating and greater savings to WMECO’s ratepayers.
Given that the special purpose trust issuing the RRBs will be formed by the Agencies, why isn’t the Commonwealth’s credit rating also a consideration for the rating agencies?
§ 1H(b)(4) includes an express provision that financing orders issued by the Department do not constitute a pledge of the full faith and credit of the Commonwealth or any of its political subdivisions (other than the special purpose trust). Because bondholders cannot look to the revenues or to the taxing authority of the Commonwealth for RRB repayment of any kind, and must rely solely on the cash flows associated with the Transition Property (including the RTC Charge), the Commonwealth’s rating has no impact on the credit rating of the RRBs.
What is the expected amortization schedule?
The expected amortization schedule will be set forth at the time of pricing and will be subject to market conditions and rating agency input. The expected amortization

schedule set forth at pricing will be included as Attachment 3 to the Issuance Advice Letter.

CREDIT ENHANCEMENT

Is credit enhancement generally necessary in securitization transactions?

Yes. Credit enhancement is often necessary in securitization transactions to provide investors with added confidence that the securities will be paid in accordance with their terms.

Beyond that, are there special needs for credit enhancement in RRB transactions?

Yes. In RRB transactions, while rating agencies may have a high degree of comfort in a utility's ability to forecast consumer characteristics and payment patterns, there will always be unforeseen occurrences (i.e., weather variations, customer movement, etc.) that may cause actual results to vary from forecasts. RTC Charge collections may vary from what was projected due to several factors, including (i) lower or higher than projected electricity usage (which may be driven by weather variations, customers entering or leaving the distribution system, etc.); (ii) lower or higher than projected uncollectible accounts; (iii) faster or slower payment rates (i.e., the time it takes for customers to pay their bills); and (iv) losses resulting from a bankruptcy of a third party supplier, the Servicer, any successor Servicer or any other collection agent. Accordingly, for RRBs to receive the highest possible rating, the rating agencies require credit enhancement to increase the likelihood of repayment to a level commensurate with a triple-A rating.

What credit enhancement features will be incorporated into the RRB Transaction to achieve the lowest all-in cost, and what credit rating does WMECO expect to receive?

The proposed RRB Transaction will incorporate an RTC Charge True-Up Mechanism and the Collection Account, which includes the General Subaccount, the Capital Subaccount, the Overcollateralization Subaccount, and the Reserve Subaccount. With all of these features, in addition to any credit enhancement required to address commingling issues as described herein, WMECO will request that the rating agencies assign the RRBs a triple-A credit rating.

Would you please describe the RTC Charge "true-up" mechanism that will be used in the RRB Transaction?

The RTC Charge "true-up" mechanism ("True-Up Mechanism") is a periodic adjustment to the RTC Charge, which serves to reconcile the actual RTC Charges collected, across all customer classes, against the RTC Charges expected to have been collected. This process is contemplated in § 1H(b)(5), and serves to ensure that there are adequate funds to recover (a) the principal balance of (in accordance with the expected amortization schedule), and interest on, the SPE Debt Securities authorized under the Financing Order, (b) the costs of issuing, servicing and retiring the SPE Debt Securities and the RRBs, including the Servicing Fee, the Administration Fee, fees for the trustees, rating agency fees, legal and accounting fees, managers'/directors' fees, contingent liabilities of the SPE arising from indemnity obligations in the RRB Transaction documents, and other related fees and expenses (collectively "servicing and administrative expenses"), and (c) the cost of creating and maintaining any credit enhancement required for the SPE Debt Securities and the RRBs (the required periodic payment of such, including deficiencies on past due amounts, "Periodic RRB Payment Requirement" and, collectively, "Total RRB Payment Requirements"). Through the True-Up Mechanism, investors' exposure to losses due to shortfalls in projected sales of energy, longer-than-expected delays in bill collections, and higher-than-estimated write-offs is significantly mitigated. This feature addresses any cash flow variability, and is a positive factor in reducing the need for additional credit enhancements, because the True-Up Mechanism has no up-front cost.

In accordance with this adjustment mechanism, WMECO, as initial Servicer (or any successor Servicer) on behalf of the SPE, will annually file with the Department periodic true-up advice letters ("Routine True-Up Letters"), in substantially the form of Appendix B to the Proposed Financing Order Appendix, prior to each anniversary of the date of the Financing Order, or more frequently if necessary. The Servicer may also file Routine True-Up Letters before the end of any calendar quarter or payment date to adjust the RTC Charge. The resulting adjustments to the RTC Charge will be effective on the first day of the succeeding calendar month, or such date as may be specified in the Routine True-Up Letter, as long as such effective date is at least fifteen days after the filing of such Routine True-Up Letter.

In addition, whenever WMECO, as initial Servicer (or any successor Servicer) determines that the True-Up Mechanism used to calculate RTC Charge adjustments requires modification to more accurately project and generate adequate RTC Charge collections, a non-routine true-up advice letter ("Non-Routine True-Up Letter") may be filed, with the resulting RTC Charge adjustment (reflecting such modification to the methodology or model) to be effective upon review and approval by the Department within 60 days after such filing.

Both Routine True-Up Letters and Non-Routine True-Up Letters may be filed periodically through the legal final maturity date. In the last year that the SPE Debt Securities and the RRBs are scheduled to be outstanding, quarterly or monthly Routine True-Up Letters may be filed.

What would cause WMECO to need to adjust the RTC Charge via the True-Up Mechanism? Simply stated, any prior or projected variations in RTC Charge collections. RTC Charge collection variations may have occurred since the last True-Up Mechanism adjustment (or since the initial issuance of the RRBs in the case of the first true-up) due to any of the factors already described. These variations may have resulted in the SPE’s inability to meet the Periodic RRB Payment Requirement. Further, RTC Charge collection variances may be projected to occur resulting from updated Servicer forecasts with respect to electricity usage, charge-offs, payment rates, etc. RTC Charge collection variances may also be projected if (i) the weighted average interest rate on the RRBs changes over time as earlier-maturing classes are repaid, (ii) principal amortization for the following period is greater or less than that for the prior period, or (iii) expenses of the SPE change over time. These variances may result in the SPE’s inability to meet the Periodic RRB Payment Requirement.

How will the adjusted RTC Charge be calculated?

The RTC Charge to be billed during any period must be derived such that the resulting RTC Charge collections during that period are sufficient to (i) pay principal and interest with respect to the SPE Debt Securities and the RRBs in accordance with the expected amortization schedule, (ii) pay servicing and administrative expenses, (iii) maintain the Overcollateralization Subaccount balance at the required levels, and (iv) restore the Capital Subaccount to the balance originally required upon the inception of the transaction. Further, any amounts in the Reserve Subaccount on any true-up date will be taken into account when calculating the adjusted RTC Charge such that the balance in the Reserve Subaccount will be expected to be zero at the end of the period for which the RTC Charge is being adjusted.

If, at any time, the RTC Charge collections and investment earnings thereon exceed the amount necessary to amortize the RRBs to the level set forth in the expected amortization schedule, such excess will be held in the Reserve Subaccount and will serve to reduce the RTC Charge and the required amount of RTC Charge collections in the subsequent period. Conversely, if the available RTC Charge collections are less than the amount necessary to pay fees, expenses, interest, to amortize the RRBs to the level set forth in the expected amortization schedule and to get the necessary subaccounts to their target level, then the RTC Charge and the required amount of RTC Charge collections in the subsequent period will be increased to reflect such shortfall.

Please describe the Collection Account.

Upon issuance of the initial series of SPE Debt Securities, the SPE will establish a Collection Account, which will consist of the General Subaccount (which will hold the RTC Charge collections before each payment date) and at least three other subaccounts—the Capital Subaccount, the Overcollateralization Subaccount, and the Reserve Subaccount (all described below). Additional subaccounts may be established in respect of additional credit enhancements. These subaccounts will be maintained and administered in trust by the trustee for the SPE Debt Securities and will be used to cover certain RTC Charge collection shortfalls.

RTC Charge collections will be remitted to the Collection Account, from where they will be allocated, based on priority, either to pay fees, expenses, or principal and interest on the RRBs and to the various subaccounts, all as described herein.

Moneys on deposit in the Collection Account will be invested in high-quality, short-term investments meeting the stringent criteria of the rating agencies. Interest earnings will be available to make payments on RRBs.

WMECO, as initial Servicer (or any successor Servicer), will account for, and ultimately credit to ratepayers, any amounts remaining in the Collection Account (other than the Capital Subaccount and an amount equal to interest earnings thereon) after the RRBs are paid in full. Such amounts include any overcollateralization amounts, including interest earnings thereon, or RTC Charge collections that remain after the Total RRB Payment Requirements have been discharged. Such amounts will be released to the SPE in accordance with § 1H(b)(7), upon retirement of the RRBs and discharge of the Total RRB Payment Requirements. These benefits will inure to ratepayers through a credit to their transition charge, or if there is no transition charge, through a credit to other rates. If WMECO, as initial Servicer (or any successor Servicer), is making RTC Charge remittances less frequently than daily, WMECO (or such successor Servicer) will account for and remit to the trustee for the SPE Debt Securities any interest on RTC Charge collections.

Please describe the Capital Subaccount.
The Capital Subaccount is used to hold the initial equity contribution required by the Internal Revenue Service ("IRS") for the favorable private letter ruling described below, and also serves as a credit enhancement mechanism as it is available to cover certain shortfalls in RTC Charge collections. WMECO anticipates that the Capital Subaccount will be funded by WMECO at issuance in an amount equal to at least 0.50% of the original issuance amount. To the extent that the Capital Subaccount is depleted, it will be replenished through the RTC Charge, as adjusted periodically.
Please describe overcollateralization and the Overcollateralization Subaccount.
Overcollateralization exists when security holders have purchased or are secured by an asset and its related revenue stream – in this case, the Transition Property, represented by the RTC Charge – having a value in excess of the investment made by the security holders, thereby increasing the likelihood of repayment of the investment and a return thereon. The RTC Charge for any period will be calculated to yield expected annual collections in excess of those required to satisfy payments of principal, interest, fees and expenses which are scheduled to be paid during that period. The aggregate amount of such expected excess collections over the term of the RRBs is the "Overcollateralization Amount." Such excess will be deposited into the Overcollateralization Subaccount. Overcollateralization protects against the risk of RTC Charge collection shortfalls due to variability of energy sales, changes in customer payment and charge-off patterns, changes in ongoing costs of RRBs, and losses due to commingling of funds in the event of a WMECO bankruptcy.
What will be the Overcollateralization Amount?
The Overcollateralization Amount for the SPE Debt Securities currently is expected to be at least 0.50% of the initial principal amount of the SPE Debt Securities which will be collected ratably over the life of the RRBs in equal increments. The actual Overcollateralization Amount required to achieve the highest credit rating will be finalized prior to the issuance of the RRBs and will depend primarily on rating agency requirements and tax considerations.
WMECO intends that the amount of overcollateralization, when finalized, will assure that the RRBs receive the most economical rating, and the most efficient pricing, thereby providing the most cost effective transaction for WMECO and its Retail Customers. As with other forms of credit enhancement, the final determination of overcollateralization amounts deposited in the Overcollateralization Subaccount will be included in the description of the transaction when WMECO provides such information in the Issuance Advice Letter filed with the Department prior to the issuance of RRBs.

Please describe the Reserve Subaccount.
RTC Charge collections and investment earnings thereon, if any, in excess of the Periodic RRB Payment Requirement will be allocated to the Reserve Subaccount rather than being used to accelerate principal repayment. Such amounts will be available to cover subsequent RTC Charge collection shortfalls and will be factored into the

True-Up Mechanism as described herein.
Presented below is a summary of the targeted balances for each of the Collection Account subaccounts:

SUMMARY OF COLLECTION ACCOUNT SUBACCOUNTS

Subaccount	Description	Targeted Balance
Capital	Equity contributed by WMECO at issuance	At least 0.50% of issuance amount
Overcollateralization	Collected pro rata through RTC Charge over life of issue	At least 0.50% of issuance amount

(assuming a 12 year expected final maturity, 0.04% of issuance amount in the first year, 0.08% of issuance amount in the second year, etc.)

Subaccount	Description	Targeted Balance
Reserve	Accumulates any excess collections	$0.00
General	Holds collections of principal, interest, fees and expenses	$0.00

How are the amounts in the Collection Account allocated?
The following represents the primary categories of allocations from the Collection Account:
Expenses and fees of the SPE and the special purpose trust, including trustee and servicing fees, and the administration fees, up to a cap, if any, specified by the rating agencies;
Interest on RRBs;
Scheduled principal on RRBs;
Any unpaid expenses and fees of the SPE;
To the Capital Subaccount up to the initial balance;
To the Overcollateralization Subaccount up to the targeted balance;
To a hedge or swap counterparty, if any, termination or breakage amounts owed, if any;
To the SPE up to the investment earnings on the Capital Subaccount; and
To the Reserve Subaccount the amount of any excess in the Collection Account after the allocations in 1 through 8 above.
The following diagram provides a general summary of the flow of funds from Retail Customers, through the Servicer to the Collection Account and the various allocations. Numbers in the diagram indicate priority of remittance of proceeds.

allocations and distributions

How does the Collection Account operate during times of RTC Charge collection shortfalls?
If RTC Charge collections in any period are insufficient to satisfy the SPE’s payment obligations on the SPE Debt Securities, then amounts in the Reserve Subaccount, the Overcollateralization Subaccount, and the Capital Subaccount will be used to satisfy scheduled principal and interest payments, respectively. To the extent that amounts in the Overcollateralization Subaccount or the Capital Subaccount are used to satisfy principal and interest payments on the SPE Debt Securities, future RTC Charges will be adjusted to restore those amounts through the True-Up Mechanism.
How does the Collection Account operate during times of RTC Charge overcollections?
If RTC Charge collections in any period exceed that necessary to satisfy the Periodic RRB Payment Requirement, the excess will be deposited to the Capital Subaccount (to the extent that the subaccount balance falls below the required capital level), to the Overcollateralization Subaccount (to the extent scheduled) and then to the Reserve Subaccount. Any excess amounts deposited to the Reserve Subaccount will be factored into the True-Up Mechanism to reduce the following period’s RTC Charge as described above.
Will any additional credit enhancement features be required?
WMECO may be required to obtain a letter of credit or other credit enhancement to protect against any cash collection losses resulting from the temporary commingling of funds. If such credit enhancement is required and WMECO, as Servicer, is remitting collections of RTC Charges to the SPE (as described below) on a daily basis, the RTC Charge would be adjusted accordingly to include fees related to such credit enhancement. If WMECO, as Servicer, makes such remittances less frequently than daily, WMECO will pay such fees.
SERVICING THE TRANSITION PROPERTY
Who will act as Servicer of the Transition Property?
Initially, on behalf of each SPE and pursuant to the Servicing Agreement, WMECO will act as Servicer of the Transition Property and will be responsible for calculating, billing, collecting, and remitting the RTC Charge from all present and future Retail Customers that are obligated to pay them. WMECO, therefore, will carry out billing and collection activities both as Servicer with respect to the RTC Charges – on behalf of the SPE and the RRB holders – and as principal with respect to its own charges to be paid by such customers.
WMECO may not voluntarily resign as Servicer or transfer its servicing obligations without obtaining the prior approval of the Department, although the RRB holders may remove WMECO as Servicer and appoint a successor Servicer in certain limited circumstances.

Any successor to the WMECO distribution system, any successor to WMECO resulting from a merger, sale, reorganization or otherwise and any other successor Servicer appointed by the RRB holders will be obligated to perform all of the obligations of WMECO as the initial Servicer under the Servicing Agreement pursuant to the Financing Order.

Describe the RTC Charge billing, collection, and remittance procedures carried out by WMECO, acting in the capacity of Servicer.
As Servicer, WMECO will bill and collect the RTC Charge and retain all books and records regarding the RTC Charge, subject to the right of the SPE and the special purpose trust to inspect those records. WMECO will periodically remit (as frequently as required by the rating agencies and, in accordance with § 1H(b)(8), in all events within one calendar month of collection) collections of RTC Charges to the SPE. To the extent that estimation of such collections is required, WMECO will design a methodology that will be satisfactory to the rating agencies, and that will approximate most closely actual collections.
The described collection activities will be subject to the Department’s regulations regarding collections, customer relationships, and other consumer-related matters. WMECO, as the approved Servicer, may not resign or transfer its servicing obligations, except to a successor distribution company, and only to the extent that such transfer does not degrade the credit quality of the RRBs.

Will WMECO be paid a Servicing Fee?
In order to support each SPE’s legal status separate and apart from WMECO, WMECO will be paid a market-based Servicing Fee for the administration costs of servicing the Transition Property. The annual Servicing Fee, payable semiannually or more frequently pursuant to the Servicing Agreement, will be equal to approximately 0.05% per annum of the initial principal balance of RRBs and will be collected through the RTC Charge. The Servicing Fee represents a reasonable good faith estimate of an arm’s-length, market-based fee for servicing the RRBs. Such servicing responsibilities include, without limitation, billing, monitoring, collecting, and remitting RTC Charges, systems modifications to bill, monitor, collect, and remit RTC Charges, reporting requirements imposed by the Servicing Agreement, procedures required to coordinate with third party suppliers (described below), required audits related to WMECO’s role as Servicer, and legal and accounting functions related to the servicing obligation. The Servicing Fee paid to WMECO will be lower than the Servicing Fee paid to a successor Servicer that does not concurrently bill the RTC Charge with charges for other services (or to WMECO if it ceases to concurrently bill) to reflect the higher costs related thereto.
Will any successor Servicer be paid a Servicing Fee?
Yes. If the successor Servicer is not billing the RTC Charge in conjunction with the other charges, then the Servicing Fee payable to such successor Servicer will be up to 1.25% per annum of the initial principal balance of the RRBs. The Servicing Fee would be higher in this case due to the fact that the successor Servicer would not otherwise be sending bills to and making collections from Retail Customers, and therefore the cost to that successor Servicer associated with servicing the RTC Charge and the RRBs is higher.
What policies do you recommend to ensure that each SPE continues to receive revenues in the event of a default in payment by any Servicer?
WMECO recommends that, in the event of a default by any Servicer in payment of the RTC Charges to an SPE, the Department will, upon application by (i) the trustee or holders of the SPE Debt Securities, (ii) the trustee or holders of the RRBs, (iii) the trustee for the special purpose trust, (iv) such SPE or its assignees, or (v) pledges or transferees of the Transition Property and Other SPE Collateral, order the sequestration and payment to or for the benefit of such SPE or such other party of revenues arising with respect to the Transition Property and Other SPE Collateral. This will provide additional certainty that the RTC Charges will benefit the owner of the Transition Property and should serve to enhance the credit quality of the RRBs.
Will any parties other than WMECO or a successor Servicer be permitted to bill and collect RTC Charges?
If third parties are permitted by the Department to bill and collect RTC Charges, the RRB holders’ exposure to the credit of such third parties would have to be limited in order to maintain the high ratings on the RRBs. As has been the case in other states, if it is expected that the Department may authorize third parties to bill and collect RTC Charges, such third parties would be required to meet specified creditworthiness criteria and to comply with specified billing, collection and remittance procedures.
Are the concerns the rating agencies have with third party suppliers the same concerns that were present in Boston Edison Company’s RRB transaction?
Yes. Billing, collection, and remittance of RTC Charges by a third party supplier ("TPS") may increase the risk of shortfalls in RTC Charge collections by exposing the cashflow to potential interruption due to the default, bankruptcy, or insolvency of that TPS. This risk of interruption will increase risks to investors, potentially reducing the credit rating and increasing the rate of interest on RRBs that would be required by investors. Rating agencies have been particularly concerned because many TPSs will likely be unrated start-up companies.
How then do you propose that the Department deal with the TPS issue?
WMECO proposes to adopt the TPS standards approved by the Department in Boston Edison Company, D.T.E. 98-118 ("BECO Docket"). Specifically, WMECO proposes that the Financing Order provide that the Department will not authorize a TPS to bill and collect the RTC Charge for remittance to WMECO as Servicer (or any successor Servicer) unless such TPS meets specified creditworthiness criteria and complies with specified billing, collection, and remittance procedures and information access requirements. Additionally, WMECO proposes the following minimum criteria,

procedures, and requirements, as approved by the Department in the BECO Docket:
The TPS must agree to remit the full amount of RTC Charges it bills to Retail Customers, regardless of whether payments are received from such customers, within 15 days after WMECO’s (or any successor Servicer’s) billing date for such charges.
The TPS must provide WMECO (or any successor Servicer) with total monthly kWh usage information in a timely manner for the Servicer to fulfill its obligations, as such information is the basis of such remittance.
WMECO (or any successor Servicer) will be entitled, within seven days after a default by the TPS in remitting any RTC Charges billed, to assume responsibility for billing all charges for services provided by WMECO (or any successor Servicer), including the RTC Charges, or to switch responsibility to a third party.
If and so long as such TPS does not maintain at least a triple-B long-term unsecured credit rating from Moody’s Investors Service or Standard & Poor’s, such TPS shall maintain with the Servicer, or as directed by the Servicer, a cash deposit or comparable security equal to one months’ maximum estimated collections of RTC Charges, as agreed upon by WMECO (or any successor Servicer) and the TPS.
How will RTC Charges be recovered in the event of a TPS default?
As approved in the BECO Docket, in the event of a default in the remittance of RTC Charges by the TPS, such amount will be included in the periodic adjustment of RTC Charges.
ACCOUNTING AND TAX CONSEQUENCES
How does WMECO expect this transaction to be characterized for accounting and legal purposes, and treated by the rating agencies?
WMECO expects that this transaction will be classified as a financing for the purposes of financial reporting. With respect to the accounting treatment of securitized transition property, the Securities and Exchange Commission ("SEC") has stated that the right to collect transition charges is an "enforceable right." This is significant, because enforceable rights are not contemplated under the rules governing the accounting for sales of financial assets and a company’s ability, pursuant to such a sale, to achieve off-balance sheet accounting treatment for securities secured by or evidencing an ownership interest in such financial asset (i.e., not included as debt of the company for purposes of calculating leverage). Therefore, it is the position of the SEC that, for accounting purposes, the transaction will not be eligible for sale or off-balance sheet treatment and will be recorded on the balance sheet as a financing – with the RRBs represented as either debt or deferred revenue. Because WMECO files financial statements with the SEC, the RRBs will be recorded as obligations of WMECO on its consolidated balance sheet, with footnotes indicating that the Transition Property has been irrevocably sold to a bankruptcy remote entity and that it will not be available to creditors of WMECO under any circumstances.
Regardless of how the transaction is characterized for tax or financial reporting purposes, legal ownership – which is the key determinant for bankruptcy law purposes – of the Transition Property will reside with the bankruptcy-remote SPE. WMECO will structure the transaction in order to obtain both "true-sale" and "bankruptcy-remote" legal opinions from counsel.

The rating agencies and equity analysts will consider the financing off-balance sheet for analytical purposes. For example, Standard & Poor’s has indicated that "as long as the transaction is structured as a true sale for legal purposes, Standard & Poor’s will ‘back out’ for analytical purposes nonrecourse debt and associated carrying costs from the utility’s consolidated financial statements." (New Assets 1998, Standard and Poor’s, March 1998).

How does WMECO intend to have this transaction treated for federal tax purposes?
An important condition of this transaction is that it be treated as the issuance of debt for federal tax purposes. This tax treatment avoids the generation of significant taxable income and the large up-front expense that would result if the transaction were classified as an asset sale. Such an expense would effectively eliminate the economic benefits of the RRB transaction, and, therefore, the tax treatment of the transaction is critical. Similarly, for tax purposes, the interest payments on the RRBs must be deemed tax deductible when paid, thereby allowing tax to be paid as the RTC Charge is actually received by WMECO.
Utilities in California, Illinois, Montana, Pennsylvania, Massachusetts and New

Jersey have applied for and received favorable private letter rulings from the IRS. While a letter ruling only applies to the taxpayer in question, WMECO’s transaction will closely resemble the transactions for which the IRS already has granted the desired tax rulings. WMECO expects to file its ruling request letter shortly and expects to receive a favorable ruling.

Is it likely that WMECO will receive a favorable private letter ruling?
Yes. As discussed above, the structure of the proposed transaction closely resembles the Boston Edison Company transaction as well as the other RRB transactions and, therefore, an expedient and favorable ruling is anticipated. Should the IRS choose not to provide a ruling or if it rules adversely, WMECO would have to reassess the RRB Transaction and, if possible, modify it to eliminate the risk of current taxation. WMECO will seek Department approval for any modification that extends the scope or nature of the transaction beyond what has already been approved. To the extent that the IRS publishes a general revenue ruling regarding RRB transactions, it may not be necessary to seek a private letter ruling, as long as WMECO’s legal counsel concludes that such ruling is applicable to the proposed transaction.
ESTIMATE OF TRANSACTION COSTS
Please provide an estimate of the transaction costs associated with the proposed RRB Transaction.
§ 1H(a) expressly provides that "the costs of providing, recovering, financing, or refinancing the transition costs, including the costs of issuing, servicing, and retiring electric rate reduction bonds" can be included in Transition Costs authorized by the Department to be recovered in a Financing Order. Based on the estimated initial offering of approximately $261 million in aggregate principal amount of RRBs, WMECO estimates the up-front issuance expenses to be approximately $6.5 million or approximately 2.5% of such principal amount. These expenses include normal issuance expenses plus the expenses related to the use of RRB proceeds for such things as tender and call premiums, which will be driven by the terms of the securities to be retired and the market at the time such proceeds are applied. WMECO is currently reviewing its expense estimates for each up-front expense category (generally, those that appear in Attachment 1 to the Issuance Advice Letter) with representatives of the Agencies. Once the reasonableness of such expenses as estimated has been approved by representatives of the Agencies, WMECO will file with the Department a schedule of such approved expenses. The information in such schedule will be updated in Attachment 1 to the Issuance Advice Letter. To the extent that actual amounts of up-front issuance expenses are still not known at the time the Issuance Advice Letter is filed, estimates will be provided. To the extent estimates are used in the Issuance Advice Letter, actual amounts will be provided in a supplement to the Issuance Advice Letter as soon as such information is available.

In addition to up-front expenses, there will be a number of ongoing transaction expenses associated with the proposed RRB Transaction to be recovered through the RTC Charge. WMECO is currently reviewing its ongoing expense estimates for each expense category (generally, those that appear in Attachment 2 to the Issuance Advice Letter) with representatives of the Agencies. Once the reasonableness of such expenses as estimated has been approved by representatives of the Agencies, WMECO will file with the Department a schedule of such approved expenses. The information in such schedule will be updated in Attachment 2 to the Issuance Advice Letter. To the extent that actual amounts of ongoing expenses are still not known at the time the Issuance Advice Letter is filed, estimates will be provided. To the extent estimates are used in the Issuance Advice Letter, actual amounts will be provided in a supplement to the Issuance Advice Letter as soon as such information is available.

If the amount of up-front and ongoing costs associated with the proposed RRB Transaction will not be known when the Department issues its Financing Order, how will WMECO reconcile its estimate of costs against actual costs?
WMECO is requesting that the total amount of estimated costs that are approved by representatives of the Agencies be included in the total value of Transition Property that may be sold to the SPE. Actual costs will not be known until after the Financing Order has been issued by the Department and the RRBs have been issued. Up-front costs will be paid from the proceeds of the RRB offering. To the extent

that any payment is required prior to issuance, however, WMECO, as seller and initial Servicer, will make such payment and will be reimbursed through the proceeds of the RRB offering. As previously mentioned, ongoing costs will be recovered through the RTC Charge, which will be trued-up periodically. As discussed in the Soderman Testimony, to the extent that the estimated costs amounts previously included in a financing order exceed the correct amount, WMECO will provide ratepayers with a uniform rate credit through a residual value credit mechanism which would be included annually through the Transition Charge reconciliation filing.
PARTICIPATION OF THE STATE AGENCIES
Have representatives of the Agencies reviewed WMECO’s Petition and related materials?
Yes. Representatives of the Agencies have reviewed WMECO’s Petition and related materials, including the Proposed Financing Order Appendix and this testimony. Based on their knowledge and experience with other rate reduction bond financings, representatives of the Agencies have indicated that the RRB Transaction satisfies (i) all requirements under §§ 1G and 1H relating to the terms and conditions of the RRBs and (ii) historic rating agency criteria consistent with achieving the highest possible ratings for the RRBs. As indicated above, WMECO will file with the Department schedules of its estimated up-front and ongoing expenses once such estimates have been approved by representatives of the Agencies. Representatives of the Agencies have indicated that they will also approve or reject certain costs incurred after issuance of the Financing Order, but before the pricing of the RRBs. Representatives of the Agencies have also indicated that they are not aware of any provision in this Financing Order beyond that required for the necessary legal opinions or which exceeds the requirements of the rating agencies.
CONCLUSION
Please summarize your testimony.
My testimony has described the important aspects relating to WMECO’s proposed securitization of Transition Costs. I have also shown how the issuance is consistent with prior securitizations. In addition, I have presented WMECO’s estimate of the transaction costs associated with the issuance of the RRBs. As indicated above, representatives of the Agencies have indicated their support for the RRB Transaction. Finally, WMECO respectfully requests that the Department incorporate into the Financing Order the Proposed Financing Order Appendix.
Does this conclude your testimony?
Yes, it does.

ATTACHMENT A

OVERVIEW OF SECURITIZATION

A. Introduction

Securitization is the financing of a specific asset or pool of assets, through the issuance of securities, frequently referred to as "asset-backed securities" ("ABS"). For debt service and repayment of principal, these securities rely solely on the revenue stream underlying the asset or pool of assets and, as a result, their ratings are dependent upon the predictability or volatility of that associated cash flow. The underlying assets vary widely, but the most common in today’s market are residential mortgages, credit card receivables and automobile loans.

The public ABS market has developed into a significant portion of the fixed income securities market, comprising approximately 13% of public issuance volume in 1999 (excluding high yield and taxable municipal debt). In contrast, electric utility bond issuance constituted less than 2% of 1999 public fixed income issuance volume. The total public ABS issued in 1999 and 1998 was approximately $196 billion each year.

B. History

In the mid-1970s, residential mortgages were the first assets to be securitized. By selling a security supported by the receipt of future mortgage payments, a financial institution, such as a commercial bank, could "monetize" — i.e., convert to cash — the entire future payment stream from the holder of the mortgage. The proceeds of the issuance allowed the bank to re-deploy the newly acquired cash and originate new mortgages.

These securities were so well received by investors that, by the early l980s, banks and other financial institutions began to apply the same technology to new classes of financial assets, including retail auto loans, credit card receivables, home equity loans, equipment leases and student loans.

In 1985, financial institutions began issuing ABS into the public (capital) markets, and by 1990, ABS issuance volume exceeded $42 billion. The credit card ABS class (one of the most attractive asset classes to investors and the primary benchmark for setting yields on stranded cost ABS) comprised over one-half of 1990 issuance volume. Throughout that decade, the ABS market continued to grow in size, and asset classes continued to expand. This continued expansion caused credit card securitizations to comprise only 19% of 1999 issuance volume.

Total outstanding issuance of ABS has grown to almost $800 billion since the first public market offerings were completed in 1985. The first securitization of credit card receivables took place in 1986, and this asset class now constitutes about 27% of the total outstanding amount. Auto loans and home equity loans each contribute approximately 18% to 14% of the market. A third tier of asset classes includes manufactured housing, student loans and other asset types.

PUBLIC ABS OUTSTANDING

(December 31, 1999)

Asset Type	Amount ($bn)	% of Total
Credit cards	$215.8	27.0%
Home equity loans	142.3	17.8
Auto loans	108.6	13.6
Manufactured housing	46.8	5.9
Student loans	40.1	5.0
Other	245.5	30.7

Total	$799.1	100.0%

Source: Bloomberg

The pace of annual issuance in the ABS market has risen from $42 billion in 1990 to $l96 billion in 1999.

1999 PUBLIC ABS ISSUANCE

Asset Type	Amount ($bn)	% of Total
Credit cards	$38.0	19.4%
Auto loans / equipment leases	58.8	30.0
Home equity loans	68.9	35.1
Manufactured housing	12.0	6.1
Student loans	8.8	4.5
Other	9.7	4.9
Total	$196.2	100.0%

Source: Securities Data Company

The average size of ABS offerings has also increased significantly over the last several years. It is now commonplace for the larger issuers – Citibank, Chase, MBNA, Discover – to place $1 to $2 billion of securities in a multi-tranche (i.e., multi-class) offering in a single day. PECO Energy Company priced a $4 billion multi-tranche offering in March of 1999 (the offering was substantially similar to that proposed herein by WMECO). In December 1998, Commonwealth Edison Company priced a $3.4 billion multi-tranche offering (also substantially similar to the transaction proposed herein). Many issuers will also revisit the capital markets frequently in the course of a single year.

Since securitization is a financing technique that lowers the WACC (as defined below), it has been employed in stranded cost recovery and has been integral in several states' legislation regarding electric industry restructuring. Nine utilities in four states have successfully completed securitization transactions in the public market of the right to nonbypassable charges recovering stranded costs. The broad structure and credit fundamentals are substantially similar for each offering and to the transaction WMECO proposes herein.

PUBLIC RRB ISSUANCES

(As of December 31, 1999)

Utility	Amount ($ millions)	State	Date of Issuance
1. Pacific Gas and Electric Company	$2,901	CA	December 1997
2. Southern California Edison Company	2,463	CA	December 1997
3. San Diego Gas & Electric Company	658	CA	December 1997
4. Commonwealth Edison Company	3,400	IL	December 1998
5. Illinois Power Company	864	IL	December 1998
6. PECO Energy Company	4,000	PA	March 1999
7. Boston Edison Company	725	MA	July 1999
8. PP&L, Inc.	2,420	PA	July 1999
9. West Penn Power	600		

PA
November 1999

Total
$18,031

Source: Salomon Smith Barney

Each transaction represented the securitization of an irrevocable right to collect nonbypassable charges. Such right was created in each state with state legislation and a regulatory order. The right was sold to a special-purpose financing entity that, directly or indirectly, issued RRBs in the capital markets. The utilities used the proceeds to reduce capitalization. In many cases, the cost of capital benefits of securitization were used to fund customer rate reductions.

Each of the transactions received triple-A ratings from Moody's Investors Service, Standard & Poor's, and Fitch IBCA, Inc. and were issued in multiple tranches. The table below illustrates the principal payment windows and the corresponding class sizes for the four precedent transactions issued in 1999. Each of the nine successfully completed transactions incorporated a true-up mechanism similar to that proposed herein for the WMECO transaction. Overcollateralization amounts were 0.50% of initial principal on all transactions except the PECO Energy Company offering, which incorporated 2% overcollateralization due to certain cashflow issues unique to PECO Energy Company's service territory and global settlement agreement.

MARKETING OF 1999 RRB TRANSACTIONS

PECO Energy
Boston Edison Company
PP&L, Inc.
West Penn Power

Class
Prin. Pmt. Window (months)
Amount ($mm)
Prin. Pmt. Window

(months)
Amount ($mm)
Prin. Pmt. Window

(months)

Amount

($mm)
Prin. Pmt. Window

(months)

Amount

($mm)

A-1
24
$244
20
$109
20

$293
20
$74

A-2
24
275
30
171
12
178
34
172

A-3
36
667
18
103
18
303
37
198

A-4
24
459
30
171
12
201
24
156

A-5
42
465
30
172
18
313

A-6
24
993
12
223

A-7
18
897
21
455

21
454

Source: Applicable Financial Prospectus

Each of the nine successfully completed transactions was very well received by investors of traditional utility bonds and traditional ABS. Corporate utility bond buyers were afforded a new opportunity to buy highly-rated securities within an industry with which they were already familiar, particularly as the issuance of traditional corporate utility bonds declines. ABS buyers enjoyed the opportunity to diversify into the utility asset class with no principal prepayment risk (other than call features), a wide array of maturities and yields and little risk (primarily due to the true-up) that principal would be received later than expected.

The largest transaction to date was for PECO Energy Company, a Pennsylvania utility. The following chart illustrates the pricing achieved for that transaction:

PRICING OF PECO ENERGY TRANSITION BONDS
(March 18, 1999)

Class	Type	Principal Amount ($mm)	Average Life (yr)	Maturity Date	Spread (bp)	Yield (%)	Coupon (%)	Price (%)
A-1	Fixed	244.47	1.30	Mar 2001	T+16	5.502	5.48	99.97721
A-2	Fixed	275.37	3.26	Mar 2003	T+59	5.656	5.63	99.92816
A-3	Floating	667.00	4.03	Mar 2004	L+17	L+0.170	L+0.125	99.83669
A-4	Fixed	458.52						

5.37
Mar 2005
T+67
5.830
5.80
99.86822

A-5
Floating
464.60
6.28
Sep 2007
L+23
L+0.230
L+0.200
99.83970

A-6
Fixed
993.39
7.28
Mar 2007
T+80
6.073
6.05
99.87161

A-7
Fixed
896.65
8.91
Sep 2008
T+93
6.155
6.13
99.83580

Total
$4,000.00

EDSF Eurodollar stripped futures.

Source. Salomon Smith Barney.

At the time of preparation of this document, the most recently priced transaction was for West Penn Power, another Pennsylvania utility. The Boston Edison transaction, however, which was priced in July of 1999, most closely resembles WMECO's RRB Transaction. The following charts illustrate the pricing achieved for both those transactions:

PRICING OF BOSTON EDISON COMPANY RATE REDUCTION BONDS
(July 22, 1999)

Class

Type
Principal
Amount ($mm)
Average Life (yr)

Maturity Date
Spread
(bp)
Yield
(%)
Coupon
(%)
Price
(%)

A-1
Fixed
108.50
1.09
Mar 2001
L+20
5.998
5.99
99.97799

A-2
Fixed
170.60
3.13
Sep 2003
T+80
6.622
6.45
99.97574

A-3
Fixed
103.40
5.13
Mar 2005
T+85
6.572
6.62
99.97469

A-4
Fixed
170.90
7.13
Sep 2007
T+97
6.912
6.91
99.97071

A-5
Fixed
171.60
9.63
Mar 2010
T+125
7.036
7.03
99.93977

Total
$725.00

Source. Lehman Brothers.

PRICING OF WEST PENN POWER RATE REDUCTION BONDS
(November 3, 1999)

Class	Type	Principal Amount ($mm)	Average Life (yr)	Maturity Date	Spread (bp)	Yield (%)	Coupon (%)	Price (%)
A-1	Fixed	74.00	1.00	Jun 2001	T+23	6.366	6.32	99.99608
A-2	Fixed	172.00	3.00	Dec 2003	T+83	6.689	6.63	99.98112
A-3	Fixed	198.00	5.50	Sep 2006	T+82	6.868	6.81	99.99111
A-4	Fixed	156.00	7.80	Jun 2008	T+89	7.040	6.98	99.99609

Total
$600.00

Source. MCM Corporatewatch.

C. Nature of the Transaction

The structure of a typical ABS transaction is based on the underlying assets and the expected cash flows to be generated by those assets. In general, the original owner of the underlying asset sells the asset to a special-purpose financing entity. That entity then issues securities (directly or indirectly), for which the primary source of payment of principal and interest is the cash flow generated by the underlying asset that was sold. At issuance the cash flows are as follows:

ABS transactions are fundamentally different in structure from traditional corporate bond transactions. Most corporate bonds are "hard bullets" — all the principal is paid on a date-certain maturity and investors price the security based on that maturity date. In contrast, ABS are subject to uncertainty with respect to the timing of principal repayment, and most often, principal repayment occurs over a series of dates or even over the entire transaction life rather than on a "date-certain." This is because principal repayment is dependent upon the specific cash flow profile of the underlying asset. For example, if the asset is a pool of auto loans, the repayment of principal will ultimately be dependent upon delinquencies, writeoffs and prepayments of loans within the pool. Delinquencies and write-offs will slow the pace of principal retirement, and prepayments will accelerate it. For this reason, most ABS have an "expected" final maturity — the date by which all principal is expected to be repaid — and a "legal" final maturity — a date following the expected final maturity by which all principal is due. Ratings on ABS address the likelihood of receiving all principal by the legal final maturity. Investors price ABS based upon the expected average life of an ABS — the average time by which principal is repaid.

Credit and rating agency analysis of ABS differ from that of corporate bonds. Most corporate bonds are unsecured obligations of the issuing company and promise timely repayment of both interest and principal. First mortgage bonds issued by electric utilities are also secured by all the property, plant and equipment of the utility. The credit analysis of a corporate bond broadly examines the company’s financial risks (i.e., debt leverage cash flow coverage of fixed charges), operating risks (i.e., competitive pressures) and management’s overall commitment to a healthy balance sheet.

The analysis of ABS is necessarily more limited since the sole credit support comes from the underlying assets of the special purpose financing entity. Because the precise timing of the principal repayment of an ABS is subject to uncertainty, the credit analysis of ABS generally assesses the timely payment of interest and the ultimate repayment of principal by the legal final maturity date (see above).

The rating agencies perform extensive analyses — often referred to as "stress tests" — on the cash flows of the underlying asset to assess whether interest will be paid in a timely fashion and principal will be fully repaid by the legal final maturity, even when actual experience deviates significantly from predicted or historical norms. For example, if the historical charge-off experience is 2%, the analysis may examine the resilience of the structure to a 10% charge-off rate.

The rating agencies will also focus on key structural issues, such as the legal framework (i.e., transfer and valid ownership of assets, structure of financing vehicle), the historical asset performance, the detailed mechanics of servicer billing and collection and forms of credit enhancement employed. The credit quality of an ABS will also reflect the credit characteristics of the servicer and the ability to replace that servicer, if necessary.

As described above, the credit quality of an asset-backed security often reflects the statistical cash flow performance of the underlying asset (or in some cases, pool of assets). In order to achieve the highest ratings possible (i.e., triple-A ratings), some form of liquidity must be in place to protect investors from future variances in asset performance. This credit enhancement may consist of overcollateralization, reserve funds, letters of credit, senior/subordinated structures or guaranties. Overcollateralization is achieved by "up-sizing" the amount securitized to provide incremental protection to securityholders. For example, in a typical receivables securitization, the issuer may raise 90 cents for every dollar of receivables securitized in the asset pool (i.e., approximately 10% overcollateralization). Overcollateralization has been the credit enhancement method of choice for stranded asset securitization transactions and one of the primary forms of credit enhancement proposed herein for the WMECO transaction.

D. Benefits of Securitization

Securitization offers several benefits, including the following for customers:

· Any company must finance its assets with some blend of debt and equity capital, the cost of which is often referred to as the "weighted average cost of capital" ("WACC"). By securitizing an isolated high quality asset, higher leverage and a lower cost of debt can be simultaneously achieved. Thus. the issuer is able to replace higher cost equity capital with low-cost, highly-rated ABS debt. This lowers a company’s WACC, resulting in savings to the issuer. For utility issuers, these savings can be passed on to customers in the form of lower rates.

· Replacing high-cost equity with low-cost debt provides enhanced financial flexibility.

· A growing and vibrant ABS market provides corporations with additional sources for raising capital as new and more innovative asset classes are being introduced into the market.

· Because the ABS market is extremely large and liquid, issuers can structure and sell large transactions in a single financing.

Benefits to investors include: (i) enhanced credit quality, (ii) cashflow stability, (iii) liquidity and (iv) diversity of asset classes.

E. Tax, Accounting and Legal Treatment

Frequently, the tax and accounting treatments of the transfer of the asset to a special-purpose financing vehicle diverge. From an accounting viewpoint, the most desirable characterization is that the assets are deemed to be sold to the SPE, allowing the company to remove the assets from its balance sheet. While not necessary to complete a transaction, this treatment results in a cleaner balance sheet presentation and no increase in leverage. Even if this accounting treatment is not achieved, rating agencies and investors may ignore the assets and non-recourse debt for credit analyses purposes, as has been the case with utility stranded cost securitizations.

In contrast, the characterization of securitization for tax purposes is often as a financing, so that no taxable event occurs when the asset is transferred to the special-purpose financing vehicle. This tax treatment is beneficial to the issuer by avoiding the acceleration of the potential payment of tax due on the disposition of the asset.

Finally, in order to achieve a rating superior to that of the seller, the transfer of the asset must be considered a "legal true sale" (that is, in the event of bankruptcy of the seller, the asset will not be considered to be part of the seller's bankruptcy estate.

F. Role of Rating Agencies in Bond Evaluation

Due to the nature of the asset being securitized, the legal framework of the transaction is extremely important to ensure the irrevocability of the property right. The rating agencies evaluate, among other things, (a) the applicable enabling legislation from the perspective of the state pledge, true sale, security interest and irrevocability provisions, (b) the degree of political consensus within the state supporting the restructuring initiative and (c) the absence of legal challenges.

The rating agencies also run extensive cashflow "stress tests" which evaluate the ability to repay the rate reduction bonds by the legal final maturity (and interest on a timely basis) in the event of various "worst case" circumstances. For example, these stress tests may assume that the utility experiences a multiple of prior charge-off experience, that actual usage is much less than originally projected and that customers take a longer time to pay their bills than historically. Factors they will evaluate when designing a stress test they feel is consistent with a triple-A rating include competitiveness of electric prices, the number and nature of customers, the predictability of electricity demand, the historical ability to forecast demand, delinquencies and charge-offs, the impact of weather on usage and revenues, the credit quality of the servicer, competing sources of energy, technology risk and general macro-economic conditions within the utility's service territory.

The rating agencies have been quite vocal in their discussion of stranded asset securitization as reflected in the recent publication of the following research reports by the four principal agencies:

RATING AGENCY STRANDED COST SECURITIZATION PUBLICATIONS

Rating Agency	Date	Research Report
Fitch IBCA	10/98	Utility Securitization Q&A
	9/98	Utility Stranded Costs. Rating the Securitization of Transition Tariffs
Duff & Phelps	2/97	

DCR’s Perspective on the Securitization of Electric Utility Stranded Costs

4/97
Stranded-Cost Securitization. Potential Aggravation with Aggregators

Moody’s
2/00
Stranded Utility Costs Securitization: An Energized Market

10/99
Smoke, Mirrors & Stranded Costs

11/98
Stranded Utility Costs Update. Factoring Injunctive Relief Into the Rating Process

10/98
California Proposition 9 – Lights Out for the Stranded Utility Costs ABS Markets?

S&P
1998
New Assets 1998

5/97
Deregulated Electric’s Turn to Securitization for Cost Recovery

The rating agencies believe that – through the elimination of high-cost capital and removing uncertainty with respect to future stranded cost recovery – securitization can be an important tool for utilities entering the competitive generation market and will have a positive impact on their credit quality. For example, Standard & Poor’s has stated that "securitization should be positive for utility credit quality. The utility receives cash today, as opposed to a revenue stream generated by the asset over time. Furthermore, the risk of non-recovery, or that the revenue stream will be modified or halted in the future, is eliminated" (Deregulated Electrics Turn to Securitization for Cost Recovery, Standard & Poor’s, 5/15/97). Fitch IBCA, Inc. also remarked that "securitization is likely to result in lower capital costs passed through to consumers than if a similar level of stranded-cost recovery were authorized and financed at the utility’s cost of capital" (Guidelines for Rating Debt Backed by Regulatory Assets, Fitch IBCA, Inc., 9/30/96).